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Message Text

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INFO OCT-01 EUR-25 ADP-00 AID-20 NSC-10 RSC-01 CIEP-02

TRSE-00 SS-15 STR-08 OMB-01 CEA-02 CIAE-00 COME-00

FRB-02 INR-10 NSAE-00 XMB-07 OPIC-12 LAB-06 SIL-01

L-03 H-02 PA-03 PRS-01 USIA-12 ABF-01 FS-01 RSR-01

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R 091358 Z MAY 73
FM AMEMBASSY PARIS
TO SECSTATE WASHDC 9913
INFO USMISSION EC BRUSSELS

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E. O. 11652: N/ A
TAGS: EFIN, FR
SUBJ: MOVEMENTS OF SPECULATIVE CAPITAL

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SUMMARY: FRENCH AUTHORITIES APPEAR GENERALLY SATISFIED WITH WAY THEIR CONTROLS ARE NOW WORKING TO DISCOURAGE CAPITAL INFLOWS; PRESENT POLICY IS NOT TO DISCOURAGE OUTFLOWS. DURING MUCH OF JAN- FEB MONETARY STORM, UNCERTAINTIES ABOUT OUTCOME OF FRENCH LEGISLATIVE ELECTIONS DISCOURAGED PEOPLE FROM MOVING INTO FRENCH FRANCS. THUS CONTROLS WERE SIGNIFICANTLY TIGHTENED ONLY AFTER ELECTIONS AND START OF JOINT FLOAT IN MID- MARCH. IN THAT PERIOD EXCHANGE MARKETS HAVE BEEN FAIRLY CALM. FRENCH DEFEND DUAL MARKET AS USEFUL " SAFETY VALUE," WHICH, IN TIMES OF CURRENCY SPECULATION, DIVERTS PART OF PRESSURE FROM OFFI- CIAL RESERVES TO FINANCIAL FRANC RATE. GREATEST SHORTCOMING IN DUAL MARKET MAECHANISM IS LATITUDE IT OFFERS FORM NONRESIDENTS
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TO BUILD UP " COMMERCIAL FRANC" BALANCES FREELY, WITHOUT HAVING TO JUSTIFY NEED OF THEM TO MAKE CURRENT PAYMENTS TO RESIDENTS, AND TO RECONVERT THESE BALANCES INTO FOREIGN EXCHANGE AT ANY TIME AT PREVAILING RATE. WHETHER OR NOT ANY NEW CONTROLS WILL BE IMPOSED

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IN NEXT SIX MONTHS WILL DEPEND ON STATE OF EXCHANGE MARKETS. CONTROL- ORIENTED FRENCH AUTHORITIES WOULD NOT HESITATE TURN SCREW MUCH TIGHTER IN FACE OF NEW MONETARY CRISIS. HOWEVER, EVEN THEY RECOGNIZE CONTROLS ARE IMPERFECT INSTRUMENT, WHOSE EFFECTIVESNESS DECLINES AS SPECULATIVE PRESSURES MOUNT. END SUMMARY.

I. PRESENT FRENCH EXCHANGE CONTROLS DATE FROM LATE 1968, WHEN THEY WERE IMPOSED TO COUNTER SPECULATION AGAINST FRANC. BEGINNING IN MID- 1971, WITH DEVELOPMENT OF DOLLAR CRISIS, EMPHASIS WAS GRADUALLY SHIFTED TOWARDS DISCOURAGING UNWELCOME INFLOW OF FUNDS. SINCE THEN, SCREW HAS BEEN TIGHTENED OR LOOSENED SEVERAL TIMES IN FUNCTION OF WHAT FRENCH FINANCIAL AUTHORITIES JUDGED TO BE RELATIVE STRENGTH OF FRENCH FRANC VIS- A- VIS DOLLAR, ON ONE HAND, AND " HARD" CURRENCIES-- VIZ., DEUTSCHEMARK AND SWISS FRANC-- ON THE OTHER, AND HENCE ATTRACTION OF FRENCH FRANC AS HAVEN FOR SPECULATIVE MONEY. MOST AUTHORITATIVE DESCRIPTION IN ENGLISH OF FRENCH EXCHANGE CONTROLS IS CONTAINED IN IMF ANNUAL REPORT ON EXCHANGE RESTRICTIONS, 1973 EDITION OF WHICH SHOULD BE COMING OFF PRESSES ANY DAY NOW. MAIN ELEMENTS OF EXISTING CONTROLS ARE AS FOLLOWS:

A. DUAL EXCHANGE MARKET

CURRENT TRANSACTIONS OTHER THAN FOREIGN TRAVEL PAYMENTS AND RECEIPTS, CAPITAL SERVICE (PROFITS, DIVIDENDS AND INTEREST) AND PERSONAL REMITTANCES ARE HANDLED ON " OFFICIAL MARKET". SINCE MARCH 16, BANK OF FRANCE IS COMMITTED TO INTERVENE ON THAT MARKET ONLY TO PREVENT SPREAD BETWEEN FRENCH FRANC AND OTHER CURRENCIES PARTICIPATING IN JOINT EUROPEAN FLOAT FROM EXCEEDING AGREED MAXIMUM OF 2.25 PERCENT. BANK OF FRANCE WOULD NOW INTERVENE IN THIS MARKET TO BUY OR SELL NON- PARTICIPATION CURRENCIES ONLY PURSUANT TO UNDERSTANDING WITH OTHER JOINT- FLOAT PARTICIPANTS. WE DO NOT BELIEVE BANK HAS SO FAR UNDERTAKEN ANY SUCH INTERVENTION. ALL CAPITAL TRANSACTIONS AND THOSE CATEGORIES OF CURRENT TRANSACTIONS EXCLUDED FROM " OFFICIAL MARKET" ARE HANDLED ON " FINANCIAL MARKET." STATED POLICY OF BANK OF FRANCE IS NOT TO INTERVENE ON THIS MARKET. WHILE EXCEPTIONS ALWAYS CONCEIVABLE, WE BELIEVE BANK HAS CONSISTENTLY KEPT HANDS OFF. THUS RATES ARE FUNCTION OF SUPPLY AND DEMAND.

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B. SCREENING OF TRANSACTIONS.

ALL TRANSACTIONS REMAIN SUBJECT TO SCRUTINY OF AUTHORIZED BANKS, WHICH HAVE MONOPOLY IN FOREIGN EXCHANGE DEALINGS, AND WHICH MUST SATISFY THEMSELVES THAT TRANSACTIONS ACCORD WITH REGULATIONS OR ARE COVERED BY SPECIFIC AUTHORIZATION FROM EXCHANGE CONTROL AUTHORITIES. FOR EXAMPLE, RESIDENTS STILL MUST REPATRIATE PROCEEDS OF TRANSACTIONS WITH NONRESIDENTS AND, IF THEY THEN WISH TO USE PROCEEDS TO ACQUIRE CAPITAL ASSETS ABROAD, EITHER AVAIL THEMSELVES OF BLANKET AUTHORIZATIONS

-- E. G., PORTFOLIO INVESTMENTS BY RESIDENTS IN FOREIGN SECURITIES-- OR GET SPECIFIC LICENSE.

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ALL INCOMING AND OUTGOING DIRECT INVESTMENTS ARE SUBJECT TO SCREEN-
ING FOR NON- EXCHANGE CONTROL REASONS, BUT FRENCH AUTHORITIES CAN
AND DO USE THIS MECHANISM TO INFLUENCE CAPITAL FOLLOWS.
C. SPECIFIC CONTROLS DESIGNED TO DISCOURAGE INFLOWS
THESE WERE EDICTED FOLLOWING RPT FOLLOWING PARIS MONETARY
CONFERENCE OF MARCH 16:
(1) PAYMENT OF INTEREST PROHIBITED ON FRANC DEPOSITS OF
LESS THAN SIX MONTHS' TERM;
(2) RESERVE REQUIREMENT FIXED AT 100 PERCENT FOR ALL
NONRESIDENT DEPOSITS MADE ON OR AFTER JANUARY 4, 1973;
(3) NONRESIDENTS PROHIBITED FROM INVESTING IN SHORT- TERM
FRENCH SECURITIES-- NOTABLY TREASURY BILLS, CERTIFICATES OF
DEPOSIT, PREIVATE BILLS-- OR FROM MAKING ADDITIONAL DEPOSITS IN
SAVINGS BANK (PASSBOOK) ACCOUNTS; AND
(4) NET FORWARD FOREIGN EXCHANGE BUYING POSITION OF
RESIDENT BANKS VIS- A- VIS FOREIGN CORRESPONDENTS FROZEN AT FEB 28
LEVEL.

II. FOLLOWING ANSWERS TO SPECIFIC QUESTIONS POSED PARA 3
REFTEL:
(1) STRICTLY SPEAKING, THERE ARE NO " UNOFFICIAL" OR
" UNANNOUNCED" CONTROLS IN FRANCE. HOWEVER, AS INDICATED ABOVE,
AT PRESENT TIME FRENCH AUTHORITIES DO USE DIRECT INVESTIMENT CON-
TROLS TO DISCOURAGE CAPITAL INFLOWS AND MAXIMIZE OUTFLOWS. THUS
THEY MAY TELL PROSPECTIVE NONRESIDENT INVESTORS THAT OFFICIAL AP-
PROVAL OF PROPOSED OPERATION IS SUBJECT TO THE INVESTOR' S RAISING
NECESSARY FINANCING OR SUBSTANTIAL PORTION THEREOF IN FRANCE
RATHER THAN IMPORTING FUNDS. LIKEWISE THEY CAN AND OFTEN DO
REQUIRE RESIDENT INVESTORS TO RAISE ON FRENCH FINANCIAL MARKET
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FUNDS NEEDED FOR PROJECTS ABROAD, AND THEN EXPORT CAPITAL RATHER
THAN BORROWING, FOR EXAMPLE, ON EURO- CURRENCY MARKETS OR IN
COUNTRY OF INVESTMENT. THIS PRATICE WAS DEVELOPED IN LATTER
PART OF1971(SEE PARIS A-1135 OF NOV. 8, 1971), AND HAS BEEN
CONTINUED SINCE, BUT PROBABLY NOT ON A SYSTEMATIC BASIS.
(2) FRENCH AUTHORITIES APPEAR GENERALLY SATISFIED WITH
WAY CAPITAL CONTROLS " NOW" WORKING TO DISCOURAGE INFLOWS. THEY
ARE NOT CONCERNED ABOUT OUTFLOWS AT THIS JUNCTURE, AND PRESENT
CONTROL POLICY IS DESIGNED TO FACILITATE OUTFLOWS, OR AT LEAST
NOT TO IMPEDE THEM. EMPHASIS ON " NOW" IS IMPORTANT. FIRST,
CONTROLS AGAINST INFLOWS WERE TIGHTENED SIGNIFICANTLY ONLY SINCE
START OF JOINT EUROPEAN FLOAT IN MID- MARCH. SINCE THEN, THERE
HAS NOT BEEN ANY SIGNIFI
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TRSE-00 SS-15 STR-08 OMB-01 CEA-02 CIAE-00 COME-00

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L-03 H-02 PA-03 PRS-01 USIA-12 ABF-01 FS-01 RSR-01

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R 091358 Z MAY 73
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THIRD, PRIOR TO POST- MARCH 19 TIGHTENING OF CONTROLS (SEE I. C. ABOVE), FRENCH WERE MAINTAINING WHAT WAS FOR THEM RELATIVELY OPEN CONTROL SITUATION. GENERALLY SPEAKING, THEY COULD DO THIS, BECAUSE UNCERTAINTIES SURROUNDING OUTCOME OF MARCH LEGISLATIVE ELECTIONS KEPT MONEY FROM MOVING INTO FRANCE IN ANY SUBSTANTIAL VOLUME DURING FOURTH QUARTER 1972 AND FIRST TWO MONTHS 1973. INDEED, SOME FLIGHT OF RESIDENT CAPITAL SEEMED TO BE TAKING PLACE IN MODEST AMOUNTS. FRENCH AUTHOR- ITIES MADE DECISION TO KEEP " OFFICIAL" EXCHANGE MARKET OPEN ON FRIDAY, MARCH 2 (WHEN OTHER EUROPEAN MARKETS WERE CLOSED) AT LEAST PARTLY ON HYPOTHESIS THAT PEOPLE WOULD STILL NOT WANT TO MOVE INTO FRENCH FRANCS BECAUSE OF ELECTORAL UNCERTAINTIES. IT TOOK ONLY ABOUT TWO HOURS AND NET BANK OF FRANCE PURCHASES OF ABOUT $400 MILLION TO DEMONSTRATE OTHERWISE. FRENCH ARGUE THAT NEITHER THIS EPISODE NOR LARGE INTAKE INTO RESERVES IN MID-1972 AT TIME OF STERLING CRISIS IS FAIR INDICATOR OF EFFECTIVE-NESS OF CONTROLS, FOR THOSE THAT BITE HARDEST WERE NOT THEN IN EFFECT.
(3) AND (4) FRENCH AUTHORITIES APPEAR GENERALLY SATIS-FIED WITH DUAL MARKET SYSTEM AS IT HAS FUNCTIONED SINCE BEING
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PUT IN PLACE IN AUGUST 1971. THEY FEEL FINANCIAL MARKET ACTS AS SAFETY VALVE IN TIMES OF SPECULATION, DIVERTING SOME OF PRESSURE FROM RESERVES TO FINANCIAL RATE. THEY WOULD NOT ARGUE THAT IT IS ANYTHING APPROACHING PERFECT INSTRUMENT, HOWEVER, PARTICULARLY AS SPECULATION INCREASES IN INTENSITY. THEY ALSO BELIEVE 1971 REQUIREMENTS PLACED ON IMPORTERS NOT TO DRAG HEELS ON IMPORT PAYMENTS, THREATS TO RESTRICT CONVERTIBILITY OF NON-RESIDENT BALANCES ACQUIRED AFTER SPECIFIED DATE AND REGULATION OF EXTERNAL POSITION OF BANKING SYSTEM HAD TEETH. IT IS OUR JUDGMEMT, HOWEVER, THAT EFFECTIVENESS OF ALL THESE MEASURES DIMINISHES AS MARKET BECOMES MORE AGITATED, AND SEARCH TO FIND SPECULATIVE HAVENS INTENSIFIES. ONE OF THE GREATEST SHORT-

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COMINGS IN DUAL MARKET SYSTEM IS THAT REGULATIONS ALLOW NON-
RESIDENTS TO OPEN AND BUILD UP BALANCES IN " COMMERCIAL FRANC"
ACCOUNTS FREELY, WITHOUT HAVEING TO SHOW THAT ASSETS WILL
ULTIMATELY BE USED FOR PAYMENTS TO RESIDENTS THAT REGULATIONS
WOULD ALLOW TO GO THROUGH " OFFICIAL MARKET." MOREOVER, EXCEPT
FOR BRIEF PERIOD IN DEC. 1971, NONRESIDENTS CAN AT ANY TIME
RECONVERT " COMMERCIAL FRANCS" BACK INTO FOREIGN EXCHANGE AT PRE-
VAILING RATE. FINALLY, AUTHORITIES ALWAYS EXPERIENCE GREAT
DIFFICULTY IN PUTTING DAMPER ON SHIFTS IN PAYMENTS LEADS AND LAGS.
FOR ADDITIONAL BACKGROUND, WE ARE POUCHING RECENT PAPER WE PRE-
PARED EVALUATING EFFECTIVENESS OF FRENCH EXCHANOE CONTROLS
DURING RUN AGAINST FRANC NOV 1968- AUG 1969 AND DOLLAR CRISIS OF
AUG- DEC 1971.
(5) CONTROLS ON OUTFLOWS ARE BEING KEPT ON BOOKS,
AGAINST CONTINGENCY OF NEW FLIGHTFROM FRANC. HOWEVER, IN PERIOD
WHERE OBJECTIVE OF FRENCH POLICY IS ORIENTED IN OPPOSITE SENSE-,
THEY ARE NOT BEING ENFORCED VERY RIGOROUSLY. LATEST EXAMPLE IS
DECISION TO REMOVE RESTRICTIONS ON FORWARD COVER AVAILABLE TO
IMPORTERS (ITEM 3, PARIS A-293, APRIL 20).
(6) SEE I. C. ABOVE. UNCERTAINTIES AS TO HOW MARKET WOULD
REACT TO DECISION ON JOINT FLOAT AND ANNOUNCED RESULTS OF
PARIS MONETARY CONFERENCE OF MARCH 16 LED FINANCE MINISTRY
TO REACTIVATE SOME OF CONTROL MECHANISM THEY HAD EMPLOYED IN
1971.
(7) JOINT FLOAT HAS COINCIDED WITH PERIOD OF RELATIVE
CALM OF EXCHANGE MARKETS. IF THERE IS CAUSAL RELAIONSHIP
BETWEEN THE WTWO EVENTS, IT CAN BE SAID JOINT FLOAT HAS HELPED
BY LESSENING SPECULATIVE PRESSURES FROM OTSIDE . ON THE OTHER
HAND, AS NOTED POINT (2) ABOVE, SINCE JOINT FLOAT THERE HAS BEEN
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SOME TENDENCY FOR MONEY TO MOVE INTO FRANCE FROM OTHER PARTICI-
PATING COUNTRIES. GIVEN 3 PERCENT MARK REVALUATION, IN PAR-
TICULAR, THIS DEVELOPMENT COMES AS NO GREAT SURPRISE, HOWEVER.
(8) WHETHER OR NOT ANY NEW CONTROLS IMPOSED IN NEXT SIX
MONTHS WILL DEPEND ON STATE OF EXCHANGE MARKETS. IF AGITATION
BUILDS UP AGAIN WITH TENDANCY FOR MONEY FLOW INTO FRANCE,
AUTHORITIES CERTAINLY WOULD NOT HESITATE INTENSIFY CONTROL NET-
WORK ALONG LINES LATTER PART 1971-- E. G., PLACE STRICT MAXIMUM
TIME LIMITS ON PAYMENTS FOR IMPORTS AFTER PASSAGE THROUGH
CUTOMS, WIDEN REGULATION OF EXTERNAL POSITION OF RESIDENT BANKS
TO INCLUDE ALL FRANC AND FOREIGN EXCHANGE ITEMS, SUSPEND CON-
VERTIBILITY OF NEWLY ACQUIRED NONRESIDENT FRANC BALANCES AND
RESERVE RIGH TO BLOCK SUCH NEW ACCRUALS INDEFINITELY.
(9) EVEN CONTROL- ORIENTED FRENCH AUTHORITIES RECOGNIZE
THAT CONTROLS ARE IMPERFECT INSTRUMENT, AND THAT AT BEST THEY CAN
ONLY MODERATE EFFECTS OF SPECULATIVE PRESSURES. THEIR SUCCESS
IN THIS REGARD WILL BE IN INVERSE PROPORTION TO DEGREE OF ANY
SPECULATIVE PRESSURES THAT DEVELOP.
IRWIN

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